

UNITED STATES BANKRUPTCY COURT
MIDDLE DISTRICT OF NORTH CAROLINA
DURHAM DIVISION

ENTERED
DEC 28 2004
U.S. BANKRUPTCY COURT
MDNC - AHH

IN RE:)
)
Laurence D. Poindexter and) Case No. 04-81471C-7D
Sherry J. Poindexter,)
)
Debtors.)
)

MEMORANDUM OPINION

This case came before the court on October 22, 2004, for hearing on the Bankruptcy Administrator's motion to dismiss this Chapter 7. The Debtors appeared at the hearing with their attorney, Robert E. Whitfield. Appearing on behalf of the Bankruptcy Administrator was Robyn C. Whitman.

The motion to dismiss is based upon § 707(b) of the Bankruptcy Code. Under § 707(b), the court may dismiss a case filed by an individual debtor under Chapter 7 whose debts are primarily consumer debts if it finds that the granting of relief would be a substantial abuse of the provisions of Chapter 7.

The first requirement for dismissal under § 707(b) is that the debts of the debtor must be primarily consumer debts. Under § 101(8) of the Bankruptcy Code a consumer debt is a "debt incurred by an individual primarily for a personal, family, or household purpose." A debt "not incurred with a profit motive or in connection with a business transaction" is considered consumer debt for purposes of § 707(b). In re Kestell, 99 F.3d 146, 149 (4th Cir. 1996).

In the present case, the Debtors disputed that their debts are primarily consumer debts based upon the amount of debts which they say were incurred in the male Debtor's insurance and other businesses. Debtors are correct in their assertion that such debts do not constitute consumer debts. However, the evidence disclosed that at most, the business debt was \$49,370.00, which is less than 25% of Debtors' unsecured indebtedness and an even smaller percentage of their total debts. The remainder of the debt in this case is not related to a business and is consumer debt. This means that more than 75% of the debt in this case is consumer debt. The rule followed by most courts, including this court, is that the consumer debt must be over 50% of the debt in order for the debt to be considered primarily consumer debt. See In re Stewart, 175 F.3d 796 (10th Cir. 1999); In re Booth, 858 F.2d 1051 (5th Cir. 1988); In re Kelly, 841 F.2d 908 (9th Cir. 1988). It follows that the debt in this case is primarily consumer debt and that the first requirement under § 707(b) therefore is satisfied in this case.

The remaining issue is whether granting a Chapter 7 discharge pursuant to § 727 in this case would involve a "substantial abuse" of the provisions of Chapter 7. Unfortunately, there is no statutory definition of "substantial abuse" to aid in this determination. Various tests or rules for determining "substantial abuse" have been developed by the courts. The rule cited most frequently in the Fourth Circuit is the one adopted in In re Green,

934 F.2d 568 (4th Cir. 1991). In Green the court declined to adopt a per se rule under which a debtor's ability to pay his debts, standing alone, justifies a § 707(b) dismissal. Instead, while specifically recognizing that the debtor's ability to pay is the primary factor to be considered, the court ruled that "the substantial abuse determination must be made on a case-by-case basis, in light of the totality of the circumstances." Id. at 573. The court then provided the following examples of the circumstances or factors to be considered: (1) whether the bankruptcy petition was filed because of sudden illness, calamity, disability or unemployment; (2) whether the debtor incurred consumer credit in excess of his ability to pay; (3) whether the debtor's family budget is excessive or unreasonable; (4) whether the schedules and statement of financial affairs reasonably and accurately reflect the debtor's true financial condition; (5) the ability of the debtor to pay his or her creditors; and (6) whether the petition was filed in good faith. See id. In making this evaluation, the court must give effect to the presumption in favor of granting Chapter 7 relief that Congress included in § 707(b). See id.

Turning to the circumstances in the present case, there are a number of factors or circumstances which weigh against the Debtors. In the first place, this is not a case that was filed because of sudden illness, calamity, disability or unemployment. The Debtors are a married couple who reside in Sanford, North Carolina. The

Debtors are both employed and have had no dependents at any time relevant to this case. The male Debtor is self-employed, selling insurance, and the female Debtor is a long-time employee of Progress Energy. Neither Debtor experienced illness, disability, loss of employment or calamity prior to the filing of this case on May 13, 2004. Debtors' income has been substantial in the years preceding the bankruptcy filing. At the time of the filing, the Debtors listed an annual income of \$72,156.00 for the female Debtor and \$43,488.00 for the male Debtor. During 2003 the female Debtor had an annual income of \$69,633.00, while the male Debtor had gross earnings of \$43,490.00. In 2002 the female Debtor had earnings of \$68,238.00 and the male Debtor had gross earnings of \$47,749.00. In 2001 the female Debtor had earnings of \$63,560.00 and the male Debtor had earnings of \$44,538.00. In 2000 the female Debtor had earnings of \$58,196.00, while the male Debtor's gross income was \$50,024.00. In addition to this significant level of earnings, the Debtors made significant withdrawals from retirement funds and also had additional income from other sources during the period of 2000-2003. In 2000 the female Debtor made a \$5,555.00 withdrawal from her retirement plan; in 2002 an additional \$4,900.00 was withdrawn from the retirement plan; in 2002 \$45,484.00 was withdrawn from the female Debtor's retirement plan and a \$18,203.00 IRA withdrawal was made; and in 2003 \$7,128.00 was withdrawn from the female Debtor's retirement plan. In addition to these cash infusions from the

retirement plan and IRA and their earnings, the Debtors received an additional \$38,600.00 in 2002 from gambling. The result is that the Debtors had taxable income of \$88,000.00 during 2000, \$118,958.00 during 2001, \$149,465.00 during 2002 and \$88,800.00 during 2003.

It thus appears that both Debtors have had steady income which was more than sufficient to sustain a comfortable standard of living without going into debt. Nothing in the evidence suggests any type of financial stress or crisis that would explain either the filing of this case or the magnitude of the debt that apparently prompted the filing.

When this case was filed the Debtors clearly had a level of consumer debt which was beyond their ability to pay, which is another factor that weighs against the Debtors. The Debtors were unable to credibly account for their indebtedness. Despite having received the high level of income and cash flow reflected in the foregoing figures and despite the fact that Debtors had no dependents, no unemployment, no illness and no calamity, the Debtors owed unsecured indebtedness of \$196,570.00 when this case was filed in May of 2004. This unsecured indebtedness consisted primarily of the unpaid balances owed by the Debtors on sixteen credit card accounts. In addition to the \$196,570.00 of unsecured indebtedness, the Debtors listed additional indebtedness of \$113,000.00 which was incurred by the Debtors when they placed an

\$83,000.00 second deed of trust on their home in 2001 and a \$30,000.00 third deed of trust on their home in 2002. Debtors were unable to provide a plausible explanation of how this level of indebtedness was incurred by them or what they did with the money that was borrowed or charged on their credit cards. Debtors' contention that credit card interest and penalties account for the \$310,000.00 of debt which they had when this case was filed in mid-2004 is not credible. Such a contention is particularly unconvincing when one considers the large amount of cash that passed through their hands during the years immediately preceding the filing of this case in the form of earnings, withdrawals from retirement and income from gambling. The gambling income that was reported by the Debtors consists of \$38,600.00 of winnings at casinos in North Carolina, Las Vegas and on a cruise ship. The only gambling that was admitted by the Debtors essentially were the occasions when they won money. Although Debtors denied any gambling losses, no other plausible explanation was provided for the level of expenditures and debt disclosed by the evidence in this case. The unexplained level of indebtedness that prompted the filing of this case reflects either reckless spending on the part of the Debtors or living beyond their considerable means, resulting in indebtedness in excess of their ability to pay.

In this Chapter 7 case, the Debtors propose to retain all of their assets and make no payments whatsoever to their creditors.

Debtors' real property consists of their residence in Sanford which they valued at \$168,000.00 and which is subject to three deeds of trust securing indebtedness totaling \$186,215.00. The personal property listed by the Debtors totals \$186,489.00 and includes household goods and furnishings valued at \$3,611.00, clothing and jewelry valued at \$1,100.00, pension benefits valued at \$126,000.00, a 401(k) account valued at \$37,743.00, a 2000 Pontiac van and a 2000 Chevrolet Impala, both of which are shown as being subject to liens which exceed their values, a 1993 Oldsmobile valued at \$500.00, a \$600.00 boat and trailer and office equipment and supplies valued at \$650.00. The Debtors have filed claims for property exemptions in which they have claimed all of their property as exempt and the Chapter 7 trustee has filed a report of no distribution. Thus, if the Debtors are allowed to proceed in this Chapter 7 case, they will be able to retain all of their assets without their creditors receiving one cent. Considering the quantity of the debt that was accumulated by the Debtors, the circumstances under which such debt was incurred and the fact that these Debtors have the ability to pay a substantial amount to their creditors, the court is satisfied that such a result would constitute a substantial abuse of the provisions of Chapter 7.

Making an analysis of a debtor's ability to pay for purposes of § 707(b) involves examining the debtor's future income and future expenses. See Green, 934 F.2d at 572 (exploring "the

relation of the debtor's future income to his future necessary expenses" is part of the § 707(b) analysis); In re Krohn, 886 F.2d 123, 126 (6th Cir. 1989); Waites v. Braley, 110 B.R. 211, 214-15 (Bankr. E.D. Va. 1990). Generally, the ability to pay is measured by assessing how much disposable income a debtor would be able to pay his or her unsecured creditors under a hypothetical Chapter 13 plan. In re DeRosear, 265 B.R. 196, 203-04 (Bankr. S.D. Iowa 2001). The debtor's disposable income usually is determined in accordance with the definition of disposable income contained in § 1325(b)(2) of the Bankruptcy Code using income and expense figures that are reasonable and accurate. Id. at 204. Many courts base the ability to pay determination upon the percentage of unsecured debt that could be repaid by the debtor in a Chapter 13 case. The percentages regarded as reflecting an ability to pay have varied from case to case. See In re Norris, 225 B.R. 329, 332 (Bankr. E.D. Va. 1998). However, in a § 707(b) case, a court is not limited to looking solely at the percentage of debt that could be paid under a Chapter 13 plan. "Otherwise debtors would be rewarded for having more debt rather than less." In re Falke, 284 B.R. 133, 140 (Bankr. D. Ore. 2002). Thus, instead of relying upon the percentage of debt that can be paid, the court instead may look at the aggregate amount that a debtor can pay and, if that amount is substantial, may find that the debtor has the ability to pay for purposes of § 707(b). Id. "It is the ability to make a

substantial effort to pay, rather than the ability to pay a particular percentage of claims, that precludes the debtor from relief under Ch. 7." Id. As the court noted in the DeRosear case, "the essential inquiry remains whether the debtor's ability to repay creditors with future income is sufficient to make the Chapter 7 liquidating bankruptcy a substantial abuse." DeRosear, 265 B.R. at 204.

In making the assessment of whether a debtor has the ability to pay for purposes of § 707(b), it is appropriate for the court to consider whether the debtor has included expenses in the budget that are not necessary expenses and also whether the expenses claimed by a debtor can be reduced significantly without depriving the debtor and his dependents of adequate food, clothing, shelter and other necessities of life. See In re Engskow, 247 B.R. 314, 317 (Bankr. M.D. Fla. 2000) (budget was "extravagant and unreasonable" based upon the amount included for mortgage payments and utilities); In re Smith, 229 B.R. 895, 899 (Bankr. S.D. Ga. 1997) (mortgage payment of \$1,695.00 was not reasonable); In re Carlton, 211 B.R. 468, 473 (Bankr. W.D.N.Y. 1997) (residence rental of \$3,000.00 per month for a family of four was unreasonable and excessive). Thus, in assessing the Debtors' ability to pay in the present case, the court is not bound to accept the amounts of the expenses claimed by the Debtors but, instead, may make adjustments that are appropriate in determining the reasonable and necessary

expenses of the Debtors. Similarly, the income figures listed in Debtors' Schedule I may be adjusted to comport with the evidence relating to income.

The evidence in this case, including tax returns for the years 2000 through 2003, reflects a history of stable income for both Debtors which likely would continue during the life of a Chapter 13 plan. Regarding the female Debtor, the evidence reflects that her income at Progress Energy has increased from year-to-year, and is likely to continue to do so. When this case was filed, the female Debtor was earning \$72,156.00 per year or \$6,013.00 per month. According to Debtors' Schedule I, the female Debtor's net income is \$3,745.00 after deductions for taxes, insurance, etc. However, one of the deductions shown in Schedule I is a deduction of \$109.00 which is being made to reimburse the employer for extra vacation taken by the Debtor. Since this is an obligation which will be satisfied in the short term, it is appropriate to increase the female Debtor's net income to \$3,854.00 per month. The evidence reflects that there has been some fluctuation in the male Debtor's income. Based upon the male Debtor's income over the years 2000 through 2003¹, the male Debtor has had an average income of

¹The male Debtor's income has been derived from working as an independent insurance agent and a small amount from work as a musician. His income from these two sources was \$50,024.00 for 2000, \$44,538.00 for 2001, \$47,749.00 for 2002 and \$44,240.00, which yields an average monthly income of \$3,886.00 for the four years which preceded the year in which this case was filed.

\$3,886.00 per month, which the court finds is a more accurate reflection of the male Debtor's income than the \$3,624.00 figure shown in Debtors' Schedule I. These adjustments yield a joint monthly income of \$7,740.00, which the court finds is the appropriate income figure to use in assessing the ability of the Debtors to pay for purposes of the § 707(b) motion to dismiss.

Debtors' evidence regarding their budget and expenses was conflicting. In their original Schedule J the Debtors listed expenses totaling \$8,307.62, which included \$2,596.62 of expenses allegedly related to the male Debtor's insurance business. Apparently recognizing that their Schedule I was not accurate, the Debtors then submitted a modified list of expenses as an attachment to their answers to interrogatories which listed expenses totaling \$7,794.62² which included \$2,365.62 of alleged business expenses. The court does not accept either submission as a reasonable and accurate budget for the Debtors because both submissions include a number of expenses that are excessive. Debtors' budget was reviewed by the Chapter 13 Trustee after this case was filed. The evidence included the Chapter 13 Trustee's evaluation of the Debtors' budget in which he specified certain expenses that could be reduced and concluded that with appropriate adjustments to the

²The figure listed in the document as the total monthly expenses is \$7,994.62 which is not the correct total for the expenses listed in the document. The correct total for the expenses listed in the document is \$7,794.62.

excessive expenses, Debtors' monthly expenses could be reduced to \$6,294.00. The Chapter 13 Trustee's evaluation and reduction of Debtors' expenses is entirely reasonable and, if anything, was conservative in the amounts that he reduced the expenses. Accordingly, the court concludes that in assessing Debtors' ability to pay their creditors, the Trustee's figure of \$6,294.00 is an appropriate figure to use for Debtors' expenses.

Based upon the monthly income figure in this case of \$7,740.00 and reduced monthly expense figure of \$6,294.00, the Debtors have disposable income of at least \$1,446.00 which could be available to fund payments to their creditors. In a Chapter 13 case, if the Debtors submitted only a 36 month plan, a total of \$52,056.00 would become available for distribution under a Chapter 13 plan involving a \$1,446.00 monthly payment to the Chapter 13 Trustee. After taking into account the trustee fees and costs related to such a Chapter 13 case, it appears that the Debtors could pay a dividend of 25% if they were willing to proceed under Chapter 13 with a three-year plan, rather than seeking a Chapter 7 discharge. With a longer plan, the Debtors, of course, could pay a higher dividend to his creditors or, if appropriate, reduce the amount of the monthly plan payment. Of course, what constitutes a reasonable budget for a debtor is not something that can be projected with absolute precision and certainty and the dividend which the Debtors in this case would be able to pay under Chapter 13 may not be 25%.

If such is the case, it is because of the size of the excessive and unnecessary indebtedness incurred. Such a circumstance should not work in favor of a debtor faced with a § 707(b) challenge. Hence, given the debt picture and other circumstances of this case, the court is satisfied that the ability of these Debtors to pay in excess of \$52,000.00 to their creditors over a period of three years constitutes an ability to repay creditors which is sufficient to render this case abusive for purposes of § 707(b) without regard to the percentage of the payout that would be produced.

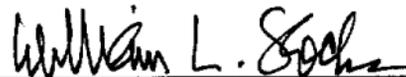
The remaining factors are whether the schedules and statement of financial affairs fairly and accurately reflect Debtors' financial condition and whether the petition was filed in good faith. It appears that with the exception of Debtors' Schedule I, the schedules and statement of financial affairs do disclose Debtors' financial condition with reasonable accuracy, which weighs in favor of the Debtors. The issue of good faith is more problematic. Whether a Chapter 7 case was filed in good faith is an important factor in applying § 707(b). See In re Kestell, 99 F.3d 146 (4th Cir. 1996) (approving a dismissal pursuant to § 707(b) based upon a lack of good faith). The requirement of good faith is intended to prevent abuse of the bankruptcy process by debtors who invoke bankruptcy to achieve an improper purpose or to take unfair advantage of their creditors. Id. at 147. There are certain aspects of this case that appear inconsistent with a good faith

Chapter 7 filing such as the unexplained magnitude of the debt and the circumstances under which such debt was incurred. However, even if the good faith issue is resolved in favor of the Debtors, the other circumstances of this case are such that the granting of a Chapter 7 discharge would involve a substantial abuse of the provisions of Chapter 7.

CONCLUSION

Having considered the totality of the circumstances presented by this case, the court concludes that the granting of Chapter 7 relief in this case would be a substantial abuse of the provisions of Chapter 7 and that this case should be dismissed under § 707(b) of the Bankruptcy Code. An order so providing will be entered contemporaneously with the filing of this memorandum opinion.

This 21 day of December, 2004.



WILLIAM L. STOCKS
United States Bankruptcy Judge

